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## Development and Structure of Financial Sector in the Economy of the Islamic Republic of Iran

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# **Development and the Structure of Financial Sector in the Economy of The Islamic Republic of Iran**

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## **Abstract**

Financial sector includes financial institutions, financial instruments, financial markets, regulations over financial sector and policy making organizations in financial sector.

Financial institutions which collect deposits of the public are consist of governmental (commercial and developmental) and private banks, non banking financial institutions, Credit Unions and Gharz-UL-Hasanah funds. Commercial insurance companies, social insurances, pension funds are contractual financial intermediaries within the Iranian economy. Investment companies which invest in securities act as investment financial institutions.

In money market, there exist banks, non banking financial institutions, Credit Unions and Gharz-UL-Hasanah Funds.

The most important capital market institution in Iran is the Tehran Stock Exchange and there is no Derivatives market.

Financial instruments within the financial sector of Iranian economy are: stocks, Participation certificates of advantageous projects and short term and long term deposits in banks.

The major regulations over the financial sector in Iran are the law for interest-free banking operation, monetary and banking law, establishment law for securities exchange and the law for issuance

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methods of participation certificates and the Establishment Law for central Insurance of Iran and insurer.

Some of the challenges within the financial sector of Iran are as follows:

Bank- base- system of financial sector, government's intervention in profit rate assignment and provision of compulsory facilities, lack of presence of private sector within the derivative market, Taking effects of monetary policy from fiscal policies and the non diversified securities within the capital market.

### **Key Terms:**

Financial Sector, Economy of Iran, Financial Institutions, Financial Instruments, Financial markets.

### **Introduction**

According to the classical economists, the financial sector together with the real sector comprise the two sectors of the economy.

In each economy depending on the circumstances and history, financial sector has its specific structure.

Recognition of the structure will help us to know the components constitute the structure, methods of performance and the status of each component and based on that become aware of how the whole structure works. Knowing how this structure works make us able to explain and forecast the future.

On this basis the main question of the research is: How is the structure of Financial Sector in Iran? And how it has been evolved during times? The hypothesis of this research is that the financial structure of Iran consists of: Financial Institutions, Financial Instruments, Financial Markets and dominated laws over the financial sector and policy making institutions.

### **1- Financial Sector from theoretical view point**

From a resource mobilization viewpoint, and considering this fact that creditors are inclined to invest or grant direct credit to those seeking it or take action through financial intermediaries, we can distinguish between direct and indirect financing methods.

In the direct method, creditors or depositors convert their funds into securities. In indirect method small investors place their money with financial intermediaries.

In the indirect method most of the financial instruments are in the form of short term and long term deposits and financial instruments of capital

market. Three of the most popular financial instruments within the financial sectors are: Bonds, Stocks, and Bank Certificate of Deposits.

## 2-Financial Institutions within Iranian Economy

We can categorize financial institutions of the Iranian economy into depository financial institutions, contractual financial institutions and investment in securities financial institutions. We will explain these financial institutions as follows:

### A: Depository Financial Institutions

Depository Institutions in the Iranian Economy consist of: Governmental (Commercial and expertise) and private Banks, Non Banking Financial Institutions, Credit cooperations, and Gharz-Ul - Hasanah Funds.

Currently governmental banks consist of six commercial banks and four expertise Banks. Commercial Governmental Banks are: Tejarat, Bank Melli, Bank Mellat, Bank Sepah, Bank Refah, Bank Saderat and expertise banks are: Bank Maskan, Bank Keshavarzi, Industry and Mine Bank and Export Development Bank of Iran.

By accepting deposits, Commercial and Developmental banks finance those who are in need of funds. The main role of banks as intermediary financial institutions, especially commercial banks, is to collect surplus funds and small investments in order to mobilize and allocate these resources.

The development of Banks from the beginning to the Islamic Revolution of Iran (1979), can be categorized into four periods:

**First:** The activity of local foreign currency exchanges (From the beginning to 1887)

**Second:** The activity of foreign banks (1887-1928).

**Third:** From the establishment of Bank Melli Iran to the establishment of Central Bank of Iran (1928-1960)

**Fourth:** From the establishment of Central Bank of Iran to the Islamic Revolution (1960-1978) (Akbar Pirouzfard, 1994, Page 9-114)

**Table No.1**

### Merged Banks after the Islamic Revolution

Name of the Bank	Type of Activity	Merged Banks
Bank Melli Iran	Commercial	This bank continues its activities with its old name
Bank Sepah	Commercial	This bank continues its activities with its old name

Bank Refah	Commercial	This bank is continues its activities with its old name
Bank Mellat	Commercial	Credits of Distribution Cooperation, Iran and Arab, Iran Insurance, Iran International, Pars, Foreign Trade of Iran, Tehran, Darioush, Omran, Farhangian
Bank Tejarat	Commercial	Shahriyar, Iran Industries, Kaar, Iran and Russia, Iranians, Iran and Middle East, Iran and England, Iran Credits, Iran Commerce, Iran and Japan International, Iran and Netherlands Trade, Iran Businesses (Iranshahr)
Bank Saderat	Commercial	Azarbijan Development, Khazar Developmnet, Khoozestan Development
Industry and Mine Bank	Expertise	Industrial Credits, Iran Mine and Industry Development, Iran Investment and Development
Bank keshavarzi	Expertise	Iran Agriculture Cooperation, Iran Agriculture Development
Bank Maskan	Expertise	Iran Mortgage, Building

**Reference:** Vali Nejad, Morteza, 1989

As illustrated in table (1) after the Islamic Revolution through the merger of old banks, six commercial banks and three expertise banks emerged.

In July 1991, another expertise bank named Export Development Bank of Iran established by general Assembly of Banks.

So the number of development banks increased to four banks. All above mentioned banks are nationalized and are controlled by government.

Currently (Year 2007) five private banks named: Parsian Bank, Eghtesad-e-Novin Bank, Saman Bank, Karafain Bank, Pasargad Bank and Sarmayeh Bank are active in Iran as well.

Five non banking financial institutions named: Bonyad Finance and Credit Institution, Mehr Finance and Credit Institution, Ansar Finance and Credit, Ghavamin Finance and Credit and Development Credit Institution are active in financial sector of Iran.

In addition to these institutions, numerous credit cooperations as depository financial institutions operate within the financial sector of Iran for example: Mol-Al-Movahedin Credit Corporation, Samen-Al-Aemeh Credit Corporation and etc. There are also a number of Gharz-Ul-Hasaneh funds which are active in Iran for example: Islamic Economy Organization, Imam Sadeq Gharz-Ul-Hasaneh Fund, Javid Gharz-Ul-Hasaneh Fund, etc.

### **B. Contractual Financial Institutions**

Commercial and social insurances and Pension Funds are the contractual financial intermediaries in the economy of Iran.

#### **1-Commercial Insurance Companies**

Insurance emerged in Iran during the first quarter of the Twentieth Century. The development of Insurance in Iran can be categorized into four periods:

##### **First: The activity of foreign Insurances:**

The monopoly right of Insurance in Iran was granted to a Russian named Poliyakof in year 1890 by king Naser-Al -Din. But since he could not meet his commitments, this royalty was cancelled.

In year 1904 within the framework of a contract, the insurance of postal packages exposed to discussion and finally in the year 1910 by establishment of two Russian Insurance companies named Nadza and Ghafghaz Mercury practically the insurance operations started in Iran.

The first period of Insurance companies activities in Iran, which was limited to foreign Insurance companies lasted for 25 years.

##### **Second: the activity of first Iranian Insurance Company**

Iran Insurance Corporation established in Iran in year 1935 by the government. Foreign insurance companies have been causing difficulties for their new Iranian competitor (in relation to reinsurance of Iran Insurance Corporation), therefore the government decided to support Iran Insurance Corporation by granting the monopoly right for the Insurance of all governmental organizations to this company and foreign insurance companies also were obliged to reinsure 25% of all their insurance policies with Iran Insurance Corporation. In the year 1937 the Insurance Act was ratified.

In the year 1952, based on the ratification of Dr. Mosadegh's administration all bank guarantees of foreign agencies changed to 250 thousand dollars of foreign currency deposit which was extendable to 500 thousand dollars.

Also the 25 % obligated reinsurance with Iran Insurance Corporation remained unchanged. As a consequence only two agencies named Yorkshire

(U.K) and Ingstrakh (Soviet Union) continued their activities in Iran. Finally in the year 1979 with nationalization of Insurance industry, the activity of these two foreign insurance agencies stopped.

### **Third: Establishment of Central Insurance of Iran**

In 1971 the act of Central Insurance of Iran and underwriting ratified. Afterwards the compulsory transfer of reinsurance from Iran Insurance to Central Insurance took place. Based on this act all insurance institutions were obliged to re-insurance 50 % of their life insurances and 25% of their other insurances by Central Insurance Company.

Before the Islamic revolution based on the ownership method, four groups of insurance companies could be identified in Iran. These insurance firms were: Iran Insurance Corporation (Governmental), private Insurance companies, multinational insurance companies (Mixed Investment) and two foreign agencies

### **Forth: After the revolution**

With the ratification of Islamic Revolution Council on June 25<sup>th</sup> 1979 insurance activity was nationalized in Iran.

Consequently of the 15 existing insurance companies, 12 private insurance companies were nationalized and the two foreign agencies disbanded.

From the middle of year 1981 the common General Meeting of these twelve insurance companies decided that only two insurance companies named (ASIA and ALBORZ) which had positive financial results, should, continue their operations and the others should only meet their obligations and pay their deferred damages. Finally in the year 1988 these ten companies restored their operation under the name of DANA insurance company.

**Table (2)**

#### **Local and Foreign Insurance Companies in Iran from the beginning to 2004**

<b>Year Underwriter</b>	<b>From the beginning to 1935</b>	<b>From 1935 to 1952</b>	<b>From 1952 to 1979</b>	<b>From 1979 to 2007</b>
Foreign	21	23	2	0
Local	0	2	13	4
Total	21	25	15	4

**Source:** Central Insurance of Iran

Currently (2007) the four governmental insurance companies in Iran are: The Iran Insurance Corporation, Asia Insurance, Alborz Insurance and Dana Insurance.

Recently private insurance companies have started their activities but they are still in the initial steps of their operation and hold a small share of Insurance market. Among these private insurance companies we can name: Mellat Insurance Co. Sina Insurance Co, Karafarin Insurance Co, Parsian Insurance Co etc. (Insurance Study Office, 1993, PP. 7-10 and Ministry of Economic Affairs and Finance PP 4-14)

## **2-Social Insurances**

New Industries and Machineries entered Iran during Ghajar Dynasty. After the entrance of these Industries the issue of Social Insurance exposed to discussion.

Because before that date there were no extensive economic activity which was in need of recruiting a large number of worker. Therefore the issue of workforce security was not existed. Only a few institutions and factories had special and limited regulations for the purpose of supporting their personnel against probable incidents.

After the year 1930 factories and Industrial Institutions gradually became active in Iran. Since personnel of these factories were exposed to on the job incidents and dangers, the existence of an organization which could support these people against danger and injuries was felt.

In the year 1930 government imposed some regulations in order to insure personnel against on the job incidents for road constructors, railway workers and miners. It was agreed that from the beginning of year 1931 one shahi (a fraction of Rial) of each worker's wage and 2% of contractual personnel's wage being deducted in order to cover the expenses of injured workers.

By this action social insurances founded in Iran. In August 1931 the code of conduct of cautionary fund prepared in the Ministry of Road and Streets.

This was the first fund related to social insurances. According to the regulations, an amount equal to three years last salary of the passed away worker will be reimbursed to his inheritor. The maximum amount of this payment should not be more than 20, 000 Rials. Therefore till that date all the social insurance expenses were on the shoulder of the workers. The second step was taken in the budget law of year 1932.

In this law the Ministry of Finance has been authorized to reimburse an amount equal to at least 10 days and at most one year wage of injured



personnel depending on the nature of incidents and the financial damages took place while working.

The social security was limited to roads workers and building constructors of governmental buildings or generally speaking was limited to those workers who were working for governmental organizations.

In second step all expenses were accepted by the government on the contrary to the first one in which all the expenses were on the shoulder of workers.

In August 1936 the code of conduct for factories and industrial institution was prepared and approved by the government. In the sixth chapter, regulations similar to regulations Cautionary Fund of Ministry of Roads and Streets was predicted. This process was in a way that those workers who were taking daily wages should pay one shahi and other workers should pay 2% of their salary to this Fund and based on these payments took advantage of these helps.

In this code of conduct it has also been predicted that workers can save part of their salaries in this Fund and get interest on it. That is why this Fund is named "cautionary and Saving Fund".

In the next step the laws of compulsory insurance of workers ratified in November 1943. Its Characteristics were as follows: (Farhang Mehr, 1986, p. 292)

- 1.Regulations of compulsory insurance only included factories with at least 20 workers.
- 2.Workers were only insured against on the job accidents.
- 3.The insurance premium varied, depending on the workers' jobs and possible dangers.
- 4.One third of insurance premium was paid by the worker and the rest was paid by contractor (employer).
- 5.The insurance of workers was given to the Iran Insurance Corporation.

According to this law the expenses were covered by worker and contractor. After this date the first Labor act was prepared. In this Act some regulations for the remedy of illnesses caused by the nature of work have been considered.

In this Act establishment of a cooperative Fund for marriage affairs, disability, retirement and etc. have been predicted.

In the year 1949 the new labor Act was approved and base on this Act all affairs related to workers were concentrated in the Ministry of Labor.

"Workers Cooperative and Insurance Fund "founded in 1950 and in 1952 changed into the 'Workers Social Insurance Organization".

Later during the years 1956-1959 the insurance premium increased to 18 percent.

In the year 1963 "Social Insurances Organization of Iran" established which was covering the owners of free professions as well.

In the year 1966 in order to generalize the social insurances, the "Social Security Organization" established and in the same year the social security law ratified.

From 1976 insurance premium increased to 30% (3% government share, 20% contractors share, and 7 percent insured person share).

After the victory of Islamic Revolution according to the ratification of Revolutionary Council in 1979 it was agreed that social security should continue its operation based on the approved law of 1966.

As before the insurance premium was 30% and it was expected that an unemployment insurance scheme would be created.

People who are covered by the social security law are:

1. People who work in receipt of wage or salary.
2. Business and profession owners no matter whether they have workers working for them (employer) or they are working for themselves (self - employed), they can take advantage of this law if they pay their insurance premium.
3. Employees of ministries and governmental institutions and companies affiliated to the government.
4. Foreigners who are legally working in Iran in case they are not covered by special supporting regulations.
5. Villager and members of their families.

According to the second article of Social Security Law, insured individuals are covered against the followings:

1. Accidents and illnesses
2. Pregnancy
3. Wage compensation (that is money paid during illness or temporary disablement)
4. Disablement
5. Retirement
6. Death( Payment to survivors )
7. Marriages allowance and child bearing
8. Unemployment insurance (for eligible individuals of social security organization who unemployed involuntarily)

In year 2004 with the establishment of ministry of Welfare and Social Security, social security organization became under the supervision and control of this ministry.

### 3-Pension Funds

In 1908 a law was approved by the first parliament regarding pension salary. Based on this law which was named pensions law, some goods and money were paid to inheritors of official servants who passed away.

For the first time the country recruitment law ratified in November 1922 and created a regime of retirement. In the forth chapter of this law the following points are mentioned regarding retirement:

1. Employees who have been providing services for an specific period of time and reached to a certain age when naturally loose their working ability can take advantage of monthly salary and social security benefits without providing services any more.
2. Whoever becomes handicapped or disabled because of an accident and no longer can continue his services will be entitled to get special salary without considering his age and period of his work.
3. Each servant who passes away, his family will get support from his contractor which is the government.

The country recruitment law has been amended during in 1929, 1945, 1958 and 1966. The new country recruitment law ratified which is applying nowadays. (Country Retirement Organization, p.15)

In the Country Recruitment Law, retirement is defined as: the state in which the official government employee with certain age and certain years of providing services according to the law and based on the order of qualified authorities will be terminated and will be eligible to receive retirement salary during the rest of his life.

The active Pension Funds in Iran and year of their establishment are listed in table No.3.

**Table No.3**

#### **List of Active Pension Funds within the Islamic Republic of Iran**

Row	Name of Organization	Year of Establish (H.S)
1	Country Pension Organization	1922
2	Social Security Organization	---
3	Armed forces Pension Organization	1956

4	Banks Joint Pension	1984
5	Central Bank Pension	1960
6	Telecommunication Company Pension	1955
7	National Iranian Oil Company Pension	1947
8	Tehran Municipality Pension	1974
9	National Steel Company Pension	1974
10	Agricultural Jihad Pension	1990
11	Islamic Republic of Iran Airline Pension	1980
12	Future Builder Pension	1976
13	Islamic Republic of Iran Shipping and Ports Organization Pension	1974
14	Iran Insurance Corporation Pension	1935
15	Iran Central Insurance Company Pension	-----
16	Construction and Pasture Pension	1970

### C) Financial Institutions Investing in Securities

The first financial investment company in Iran which established in 1975 was the National Iranian Investment Company. After that company two other investment companies named Iran Banks Investment Company and Iranian Banks Constructional Investment Company established in 1976 (Abbas Ali Arjomandi, 1372, P. 2). The activity of the last two companies stopped after the revolution but National Iranian Investment Company continued its performance after the revolution.

Currently the following investment companies are considered as the major listed investment companies in the Tehran Stock Exchange:

- Behshahr Industries Development Investment Co.
- Iran National Investment Co
- Bank Sepah Investment Co.
- Alborz Investment Co.
- National Industry Group
- Housing Investment Co.
- Petrochemical Industries Investment Co.
- Bank Melli Investment Co.
- Gahdir Investment Co.
- Shahed Investment Co

Major Investment companies which are not listed in the Tehran Stock Exchange are Social Securities Investment Co and Iran National Industries Organization Investment Co.

### **3-Financial markets within Iranian economy**

We can categorize financial markets according to different criteria. Among these, we can define them, according to kind of payment (fixed or variable revenue), maturity date (money market, capital market), and method of issuance (primary market and secondary market), organizational structure (organized markets and OTC).

#### **A. Money Market**

Participants in money market are individuals or organizations with surplus funds who invest their financial resources for a short period of time.

The most important task of money market is providing of facilities for enterprises to satisfy their short term needs to liquidity and working capital.

In the money market, both the liquidity of financial instruments and the speed of transactions are high.

The mostly recognized institutions in the money markets are the banks and short term securities are traded in the money market as well.

Active financial institutions participating in the money market include:

- 1-Commercial Banks
- 2-Experties Banks (With short term credit portfolio)
- 3-Private Banks
- 4-Non\_financial Institutions
- 5-Credit Units
- 6-Gharz-Ul-Hasanah Funds
- 7-Treasury
- 8-Central Bank as supervisor and policy maker.

Short term financial credits and claims are the instruments of money market.

The inter-banks market is another form of money market in which banks give short term loans to each other (from a few hours to a few days).

The Treasury House is a Fund and coordinating organization that handles revenue and expenses of the government.

According to article 53 of the constitution, all receivables and payables of government are concentrated with (or pay through) the Treasury House.

In fact, Central Treasury House of the country will control all the expenses of governmental organizations through the establishment of a non concentrated payment regime through Ministry of Finance and Economic Affairs.

The treasury House is therefore responsible for controlling the budget. (Hatami Zadeh and Others, 1379, P.82)

In Iran there is no organized money market in which short term financial instruments can be traded.

### **B. Capital Market**

The capital Market is a market for long term financing of funds and includes debt and equity securities. Normally the maturity date of these securities is more than one year. The most important capital market institution in Iran is the Tehran Stock Exchange. Ministry of Finance and Economic Affairs and Supreme Council of the Exchange are supervisors and policy makers in this market.

### **4- Financial Instruments**

By Financial Instruments we mean methods of financing. Methods of financing may be direct or indirect. In direct method, owners of financial resources convert their money into securities and directly finance companies which need of liquidity. Meanwhile, in indirect method this process is conducted by financial intermediaries.

On the basis of these methods, financial instruments which are applied within the financial sector of Iran's economy are:

#### **A. Stocks:**

Stock is a financial instrument for direct financing and is traded in the stock exchange. The establishment law of Tehran Stock Exchange ratified in April.

The activities of the Tehran Stock Exchange started in 1967 by trading the stocks of Industrial and Mineral Development Bank.

Within the same year Pars Petroleum Company was listed and traded in the Tehran Stock Exchange. In the year 1968 stocks of four companies including North Cement, Tehran Cement, Naishabour Sugar and Iranian Bank were traded in the Tehran Stock Exchange. In the year 1972 the number of listed companies in the Tehran Stock Exchange was more than 23 Companies.

During the Years 1973, 1974, 1975, 1976 and 1977 the number of listed companies was 34, 43, 59, 76, and 102 respectively.

The 102 listed companies in the Tehran Stock Exchange in 1977 consisted of: Twenty four banks, sixty nine production companies, four insurance service companies, five investment and development companies.

In the year 1978 the number of listed companies in the Tehran Stock Exchanged reached 105. In the year 2007 this number increased to 418

companies. The trading status of listed companies in the Tehran Stock Exchange during recent years is presented in table (4)

**Table (4):  
Performance of the Tehran Stock Exchange**

Year	Transaction Value (Billion Rial )	Average value of daily Transactions (Billion Rial)
1991	478.2	1.9
1992	352	1.4
1993	515.6	2.13
1994	793.4	3.27
1995	1880.5	7.77
1996	4381.5	18.1
1997	2017.5	8.33
1998	3116.6	12.77
1999	5243.6	21.5
2000	9176.7	38.3
2001	7830.9	32.2
2002	22776.1	93.7
2003	66869.8	278.6
2004	104202.2	428.8

Source: Tehran Stock Exchange

### **B. Participation Certificates**

With issuance of Participation Certificates for Navab project by Tehran municipality on October 1994 with the amount of 250 billion Rials and underwriting of Bank Melli Iran (as broker ), Participation Certificates as an instrument for financing of projects emerged in the financial sector of Iran's economy in order to replace bonds.

Afterward other Participation Certificates for projects such as: renovation of Abdolazim Shrine in November 1995, hospital building projects in January 1995, Samen in July 1995, new Peikan (Iranian national auto) automobile assembly line in December 1995, new residential complexes in May 1996 and other projects and also Participation Certificates of Central Bank of Iran were issued. (Table No.5)

In September 1997 the law of methods of issuing Participation Certificates ratified by the Islamic Republic parliament.

According to article 1 of this law, the purpose of issuing Participation Certificates is to enable all people in execution of beneficiary development projects for government, governmental companies, municipalities, institutions, non governmental public institutions, publicly benefit institutions and also public, private companies and productive cooperate companies.

In article 2 of this law, Participation Certificates are defined as registered or bearer securities which are issued with a fixed par value for a certain period of time and are sold to investors who are interested to participate in the implementation of beneficiary projects. (Law of methods of issuing Participation Certificates ratified in September 1997 by Islamic Republic parliament)

According to the report of the Central Bank of Iran at the end of year 2001 twenty beneficiary projects have been financed through the issuance of Participation Certificates. (Central Bank of Iran, Economical report and balance sheet for the year 2001, pages 220-221)

The owner of Participation Certificates receives a stream of declared profit on their investment until the maturity date of these securities and then they will receive the balance of actual profit and his prepayment.

**Tabel (5):**

**Issued Participation Certificates (1994- 2001)**

Participation Certificate	Issuer	First Issues	Maturity (year)	Number of Issues	Amount of Issue (Billion Rials)	Agent bank	Profit (%)
Navab Project	Tehran municipality	1994	4	4	250	Melli	20
Haram Abd-Ul-Azim project	Tehran municipality	1995	2.5	1	70	Melli	20
Hospital Project	Ministry of Housing	1995	5	1	30	Mellat	20
Saman Project	Maskan Sazan Khorasan Co.	1996	5	3	80	Saderat	20
New Payakan Project	Iran khodro Co.	1996	4	2	513.1	Melli	24 20
New Companies	Omran Co.	1997	3	1	35	Maskan	20



Tabriz Bazar	Azərbayjan Omran Co.	1997	4	1	50	Melli	20
National Participation	Government	1997	3	1	2250	Melli	20
Power Supply	Ministry of Energy	1998	3	1	300	Tejarat	20
Khark Metanol	Khark Petrochemical Co.	1998	3	1	300	Tejarat	20
Tabriz Zakaria Pharmaceuticals	Tabriz Zakaria Pharmaceuticals Co.	1998	2.5	1	30	Melli	20
National Participation	Government	1998	3	1	2500	Melli	20
Meybod Steel Project	Meybod Steel Co.	1998	4	1	70	Melli	20
National Participation	Government	1999	4	3	2000	Melli Mellat Sepah	19
Karkhe Dam	Ministry of energy	1999	4	1	150	Sepah	19
Shilat (Fishing Industry)	Ministry of Agriculture	1999	3	1	100	Keshavarzi	19
Power Supply	Ministry of energy	1999	3	1	150	Tejarat	19
National Participation	Government	2000	4	3	2000	Commercial Banks	19
Power Supply	Ministry of energy	2000	3	1	300	Keshavarzi and Tejarat	19
Acrylic Production	Polyacryl Iran Co.	2000	4	2	130	Melli	20
Power Supply	Ministry of energy	2001	1	4	1500	Saderat	17
Railway Development	Ministry of Road and Transportation	2001	1	4	400	Saderat	17
Water Supply Projects	Ministry of energy	2001	1	3	500	Tejarat and Keshavarzi	17
National Participation	Ministry of Economic Affairs and Finance	2001	1	5	2000	Commercial Banks	17

Sugar Cane Development Project	Ministry of Agriculture	2001	1	5	400	Saderat	17
Civil Development Project	Ministry of Housing and Urban development	2001	1	3	100	Maskan	17
Shilat (fishing Ind.) Development	Ministry of Agriculture	2001	1	5	200	Keshvazri	17
Implementation of Monetary policies	Central Bank of Iran	2001	2	1	600	Commercial Banks	17
Implementation of Monetary policies	Central Bank of Iran	2001	1	1	2000	Commercial Banks	17
Implementation of Monetary policies	Central Bank of Iran	2001	1	1	2000	Commercial Banks	17
Implementation of Monetary policies	Central Bank of Iran	2001	1	4	1000	Commercial Banks	17

### C. Bonds and Treasury Bills

According to the article 2 of Budget Law amendment year 1941 treasury bills were issued for the first time. According to this law ministry of finance is permitted to issue treasury bills with maturities not more than four months and include the required credit for the interest payment of these bills in the annual budget law. This permission was canceled in the following year. In fact, since people did not show any interest in buying these bills governmental organizations were obliged to purchase these notes.

According to the law bill regarding the issuance of two billions of one hundred rial loan bills by government, which was approved on August 17<sup>th</sup> 1951 the government was permitted to issue up to two billion Rials bearer with an annual interest rate of six percent for emergency cases in order to finance implementation of Oil Nationalization Law.

These national bonds issued during Mosadegh's Government, were welcomed by buyers mainly due to the reputation of Mosadegh's government and also for the purpose of supporting the country and also the specified purposes of outlays financed by these bonds.

In The cabinet gave permission to the ministry of finance to issue three months, six months and one year treasury notes with an annual interest rate of six percent.

The first series of these treasury bills were sold in July 1964. In January 1964 the issuance law of Treasury Bills ratified by the parliament and the government was authorized to issue these bills.

In the budget law for the year 1967 the government was permitted to issue defensive bonds, but because the market was not ready to purchase these bonds, central bank of Iran purchased all of them.

Sales of defence bonds continued during the years 1968, 1969, 1970 and Central Bank of Iran, National Iranian Oil Company and Bank Melli purchased them all. (Ministry of economic affairs and finance, 1357, p. 18)

In 1967 the law for issuance of agriculture Bonds approved. According to this ratification, Bank Keshavarzi was permitted to issue securities by the name of Bank Keshavarzi Bonds in order to meet its required credits for agricultural and development purposes of the country.

A small amount of these bonds were purchased by individuals and private institutions and the rest was sold to governmental institutions and banks (ministry of finance and economic affairs, 1373, P. 27).

The Utilization of bonds in order to finance part of the government general budget deficit started in 1969 by issuing one year and two year bonds and continued in the following years in order to finance government financial requirements and repayment of the previous bonds. (Ministry of finance, 1357, p. 2)

In August 1971 in order to pay the price of properties for Abass Abad project, the government issued bonds with seven years maturity and gave this amount to the land owners (Ibid, p. 23)

In May 1966 and in order to execute the law for conversion of retail owners receipts (who were eligible according to the Law of assignment and sale of rented lands to tenant farmers) receipts related to the third phase of land reform were converted into two year, three year, five year and seven year bonds and were submitted to the Iran agriculture cooperation bank and gradually delivered to the owners.

In 1975 after the establishment of ' Financial Organization for Development of Productive Units, ownership against the transferred stocks from productive units to mentioned organization some two year, three year, five year bonds with an annual interest rate equal to the interest rate of governmental bonds by the name of bonds for development of "productive units' ownership were issued and delivered to Bank Melli in order to be

delivered, in exchange of stocks, to owners of productive units who were eligible according to this law.

Bonds of this organization started to be traded in the Tehran Stock Exchange from June 1976 (Ibid, p. 24)

After the Islamic Revolution according to ratification of revolution council dated December 4<sup>th</sup>, 1979 the government was permitted to issue zero coupon bonds against the claims of Central Bank of the Islamic Republic of Iran which were originated from the credits which have been guaranteed or committed by Budget and Planning Organization and have been issued by central bank of Iran and gave them to the central bank of Iran in order to settle these claims.

Zero coupon Bonds were issued in the forms of three years, five years and seven years and the maturity date of these bonds were from the year 1991 to 1997 (Ministry of Finance and Economic Affairs, 1994, P. 30)

Issuance of public bonds were forbidden after the Islamic Revolution, therefore issued zero coupon bonds after the revolution were only for financing banks' requirement, replacing of matured bonds and also financing in flow bonds.

#### **D. Bank Deposits**

This financial instruments are in the form of short term deposits, one year, two years, three years and five years deposits and used by the banks.

#### **5- Regulations over the financial sector**

The most important regulations related to the capital market are: parts of Trade Act, and the law for the Methods of Issuance of Participation Certificates.

The most important regulations related to banking activities are: Monetary and Banking Act ratified in 1972. Act for Interest - Free Banking Operations ratified in September 1983.

The Law for Establishment of Iran Central Insurance Company and Insurers ratified by the Parliament in 1971 is also the most important Insurance legislation in Iran.

#### **6-Policy making Organizations**

Ministry of Economic Affairs and Finance, Central Bank of the Islamic Republic of Iran and Supreme Council of the Exchange are the two policy making organizations within the financial sector of Iran's Economy.

#### **7- Distinctions of Islamic Financial Markets after the Islamic Revolution**

The most important distinctions of Islamic Financial markets in Iran are:

- Replacement of a banking system which is based on Islamic contracts (Aghd )
- Implementation of profit instead of interest rate in mobilization and allocation of banking resources.
- The removal of financing through issuance of bond within the stock exchange.
- Utilization of Participation Certificates for financing.(beneficiary projects and implementation of monetary policies )
- Establishment of Gharz-Ul-Hasanah Funds

The structure of financial sector of Islamic Republic of Iran is illustrated in table 6.

### **8. Challenges of the Financial Sector**

Financial sector of Iran is bank-based. Banks are in charge of about 90% of financing activities in Iran and therefore play a monopoly role in this sector.

Lack of equilibrium in the government's budget and financing of sustained budget deficit through banking system, suboptimal allocation of resources together with credit rationing, offering facilities with preferred rates, government intervention in determining profit rates and imposition of obligatory facilities in banking system are among the issues which have caused difficulties, even sometimes in the operation of money market .

- The stock exchange which mainly represent in the capital market is not responsive to the extensive financing requirements of the country.

- The monetary policy is at the service of fiscal policies and is severely affected by it.

- Direct monetary policy instruments such as the legal liquidity ratios, assignment of credit ceilings, profit rates control, re-discounting of banks to control inflation and optimum allocation of resources, have low efficiency. Indirect instruments of monetary policy like: deposits of public sector, credit auction, open market operations and foreign exchange swap are not utilized.

- Insufficient attention is given to government financial discipline and therefore seigniorage tax is received from individuals, with potentially adverse consequences for welfare and the real sector.

- Insurance activities are mainly governmental and there is a monopoly in this sector.

- The rules and regulations of insurance companies are old and restrictive.

- Among the most important shortcomings of securities market in the country is the lack of comprehensive rules and regulations of financial markets specially capital market. Lack of regulations which guarantee

discipline of markets for investors to feel secure in these markets is obvious as well.

The necessary regulations for supervision over the activities of financial markets especially the capital market is as follows:

1. Options and Futures law
2. Over the Counter markets law
3. Companies and Investment bank Law
4. Credit rating agencies

Lack of diversification in securities market: Currently used financial instruments within the securities market are ordinary stocks and Participation Certificates. But nowadays with the approach of financial engineering the number of financial instruments is increasing. Among these securities we can name derivatives, and securitization, which are not existed in the securities market of Iran.

Table (6):

**The structure of financial sector in the  
Islamic Republic of Iran**

Bank Mellat , Bank Sepah, Bank Tejarat, Bank Melli, Bank Saderat , Bank Refah	Commercial Banks	<b>Depository</b>	<b>Financial Institutions</b>
Bank Maskan, Bank Keshavarzi, Industry and Mine Bank, Export Development Bank	Expertise		
Parsian Bank, Eghtesad-e-Novin Bank, Saman Bank, Karafain Bank, Pasargad Bank and Sarmayeh Bank	Private Banks		
Bonyad Finance and Credit Institution, Mehr Finance and Credit Institution, Ansar Finance and Credit, Ghavamin Finance and Credit	Non - banking financial Institutions		
Mol-Al-Movahedin Credit Cooperation, Samen Al-Aemeh Cooperation, Credit Cooperation ....	Credit Units		
Iran Islamic Economy organization, Javid Gharz-Al-Hasaneh Fund, Imam Sadeq (Peace be upon Him ) Gharz-Al- Hasaneh Fund, etc	Gharz-Ul-Hasaneh Funds	<b>Contractual</b>	
Iran Insurance, Alborz Insurance, Asia Insurance, Dana Insurance	Commercial Insurances		
Social Security Organization, Remedy Services Insurance Organization	Social Insurances		
Country Pension Organization, Social Security Organization, Armed forces Pension Organization, Banks Joint Pension, Central Bank Pension, Telecommunication Company Pension, National Iranian Oil Company Pension, Tehran Municipality Pension, National Steel Company Pension, Agricultural Jihad Pension, Islamic Republic of Iran Airline Pension, Future Builder Pension, Islamic Republic of Iran Shipping and Ports Organization Pension, Iran Insurance Corporation Pension, Iran Central Insurance Company Pension, Construction and Pasture Pension.	Pension funds		

Bchshahr Industries Development Investment Company, Iran National Investment Company, Sefh Bank Investment Company, Alborz Investment Company, National Industrial Group, Hosuign Investment Company, Petrochemical Industries Investment Company, National Bank of Iran Investment Company, Ghadir Investment Company, ect.	Companies listed in the Tehran Stock Exchange.  over the counter companies	Investment Companies	Investment
Social Security Investment Company, Shahed Investment Company, National Industries Investment Company and etc.			
There is no Organized Money Market in Iran	Money Market	Financial Markets	
Tehran Stock Exchange Tehran commodity exchange	Capital Market		
	Stocks	Financial Instruments	
	Participation Certificates		
Bank karafarin	Deposit Certificate		
Money and Credit Council, Supreme Council of the Exchange	Central Bank of the Islamic Republic of Iran & Ministry of Finance and Economic Affairs	Policy making organizations within the financial sector	

### Conclusion

The financial sector of Iran has a structure which has formed over the last eighty years. Commercial and expertise banks form the dominated institutions in the financial sector of Iran's economy and therefore financial sector of Iran is a bank based system. Commercial insurance and Pension Funds are the dominant financial institutions in the contractual financial institution sector of Iran's economy.

Non-Islamic Monetary instruments such as bonds and treasury bills were forbidden after the Islamic revolution and they replaced by Participation Certificates. Organizing the capital market, decreasing of government



interventions in money market and increasing of competition are among the most important challenges within the financial sector of Iran's economy.

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